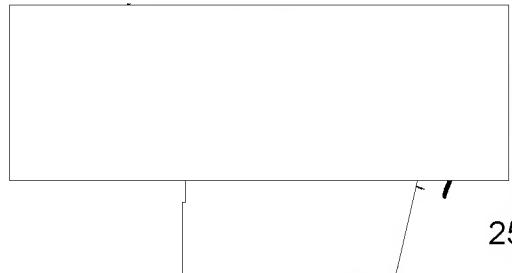




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Status of Economic Denial Measures Against the USSR

An Intelligence Assessment

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ER 80-10378
June 1980

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An Intelligence Assessment

*Research for this report was completed
on 12 June 1980.*

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This paper has been coordinated with the Office of
Political Analysis. [redacted]

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**Status of Economic
Denial Measures
Against the USSR**

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Summary

Economic denial measures against the USSR have not drawn much support from our Allies. At best they have been reluctant partners with responses seemingly aimed more at placating Washington than punishing Moscow. All the West European countries and Japan have kept the door to the Soviet market ajar, and each has been mindful not to take a markedly tougher stand on sanctions than its neighbor. In large part because of this lack of cooperation, sanctions have had little impact so far. The single exception is the grain embargo, which has strained domestic feed supplies in the USSR and forced cutbacks in the important livestock sector.

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The USSR has been threatening to strike back against Western denial measures with sanctions of its own. We doubt the threats will turn into action, however, because of the increasingly severe problems a long-term embargo of technology transfer would impose on the Soviet economy.

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Status of Economic Denial Measures Against the USSR

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Status of Sanctions

Agriculture. The Soviets have been able to replace 6 million tons of the 17 million tons of denied US grain in the current US-USSR Long Term Grain Agreement (LTA) year ending 30 September. Most of this replacement grain has come from Argentina, although Canada also sold grain after the embargo was announced. We doubt that the Soviets can obtain more than another 2 million tons of grain for delivery this LTA year, leaving them 8-9 million tons short of preembargo expectations.

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The Soviets are successfully coping with the embargoes on other agricultural products. The 1.2 million tons of soybeans and meal denied by the United States have been fully replaced—800,000 tons of beans from Argentina and 400,000 tons of meal from Western Europe. Moscow has also partially mitigated the effects of the US denial of 63,000 tons of meat and poultry. The Soviets bought at least 185,000 tons of meat from January to April, compared with an estimated purchase of 265,000 tons from Western suppliers in all of 1979. Soviet orders of super-phosphate fertilizer and phosphoric acid apparently will replace about one-fourth of the 1 million tons of embargoed US material.

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Technology. Moves to limit nonagricultural exports to the Soviet Union consist of withholding government-guaranteed export credits by the major Allies, tighter COCOM controls, and assurances not to fulfill contracts vacated by US firms because of sanctions.

- Although the US appeal that its Allies suspend government-guaranteed export credits to the USSR has been rejected or left unanswered, most countries thus far have limited new credits to the USSR in 1980. Except for France, which has negotiated a new multiyear credit agreement to take effect this month, the Allies have viewed more favorably the proposal to shorten credit maturities, provided that the French agree.

- Some support exists in principle for US requests for tighter COCOM controls. Member countries appear willing to go along with a "no exceptions" policy, but the "process control technology" proposal for military-related items has received a chilly response.
- The request not to replace US firms for Soviet contracts has been narrowly interpreted. Only in the case of the Novolipetsk steel contract abandoned by Armco steel has a government instructed its firms not to enter a bid.

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In spite of Allied reservations about the use of sanctions, Soviet orders for Western machinery and equipment have fallen sharply this year. New contracts during the first quarter amounted to only \$300 million—less than half the \$725-million quarterly average of the past two years. Some major contracts that appeared ready for signature, such as the US-West German deal for the Sayansk aluminum smelter, have been shelved or delayed. But denial measures have not put a crimp in Western sales of large-diameter steel pipe; the completion of a pending sale by Japan will push Soviet purchases to record levels.

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Olympic Boycott. Fifty-three of the approximately 145 countries invited to the Moscow Games voted not to participate, in support of the US call for a boycott. Although athletes from France, the UK, and Italy will participate, the teams will be diluted by individual and federation decisions not to attend. The UK team, for instance, is expected to be only about three-fifths the size of the team that went to Montreal in 1976.

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Summit Country Positions

All the key West European governments and Japan issued immediate and, in most cases, strong condemnations of the Soviet invasion of Afghanistan. All supported the grain embargo and agreed to close ranks by not proceeding with new credit extensions or taking over US contracts. Since then most government positions have softened. The new multiyear credit

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agreement between France and the USSR allows French firms to trade with the USSR on essentially the same terms as before the Afghan invasion. France and West Germany have not formally endorsed the key COCOM proposals.

Allied reluctance to sustain the sanction effort mainly reflects a deep-seated aversion to developing an adversary relationship with the USSR. Also of concern are fear of the loss of Soviet markets and West European vulnerability to a cutoff in Soviet energy supplies. Most US allies are suspicious of the constancy of their Summit partners in adhering to the sanctions and are uncertain about how long the US Government will keep sanctions in place.

Concerns of Major Governments

For *West Germany*, Ostpolitik is a critical element in its foreign policy. Aside from its conviction that detente is vital to reducing the risk of war, Bonn sees good relations with Moscow as necessary to improved relations with East Germany. Economic relations with the USSR are also important to West Germany. Although accounting for only 2 percent of West German exports and imports, the Soviet Union is an important supplier of energy and a major market for steel and capital goods.

West German officials

are skeptical about the effectiveness of economic sanctions and an Olympic boycott. Initially, Bonn said it would adhere strictly to COCOM regulations on sales of high technology and refrain from replacing any canceled US sales. The West Germans assert that they will not curtail credit guarantees for the USSR but have thus far stalled on approving such financing as well as on signing major new contracts.

Motivated by their supposed special relationship with the USSR, the *French* have maintained consistently that the West should not isolate the Soviets because of

Afghanistan. The French Government's posture underlines French independence in a pre-election period. It is also calculated to preserve economic ties with Moscow that the French are convinced will outlast current US policies. Paris's willingness to join sanctions against Moscow runs counter to France's desire for Soviet energy; imports of Soviet gas are scheduled to grow substantially in the 1980s. Although they have taken a harder line in [redacted] talks with the Soviets, the French have done little to apply economic sanctions beyond promising not to replace US firms in contracts from which they have withdrawn and not to take advantage of the grain embargo. They have also stated [redacted] they will tighten up on high-technology exports to the USSR, although they have opposed a more restrictive formal policy within the COCOM framework.

Japan has been the staunchest supporter of Allied sanctions. From the start Tokyo has agreed that the Soviet Union should be penalized for its invasion of Afghanistan and has consistently supported US calls for economic countermeasures. Japan has abstained from participating in major new Siberian development projects, denied official Export-Import Bank credits for major nonenergy-related export deals, and supported strict application of COCOM controls.

The *Italian* Government has pledged solidarity with the United States in the Afghanistan crisis, but mounting domestic pressures combined with political instability could weaken the government's resolve. The Cossiga coalition government already faces a tough uphill battle with the Communist party and can ill afford to alienate the business community, which continues to press for a resumption of commercial ties. Moreover, Rome believes it is suffering unfairly for supporting US objectives and that it is doing more than most other European allies.

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Italian officials are afraid that US proposals for restraints on Soviet trade will cut deeply into Italian exports. Italy's trade deficit with the Soviet Union jumped more than 50 percent last year (to \$850 million) as Italians paid more for energy and raw materials imports from the USSR. Rome is eager to narrow the deficit through expanded sales of machinery and equipment. Although the government is not anxious to grant the Soviets preferential credit terms, it fears that failure to meet terms offered by other industrial nations will seriously undercut its competitiveness. Rome thus opposes limits on credit maturities, believing that shorter maturities would not supply the type of financial backing needed to carry out Italian-sponsored projects.

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The *United Kingdom* has generally supported trade sanctions. The low level of economic relations between London and Moscow relative to the other European countries has made it easier for London to do so. The five-year official credit line which expired this January was never fully tapped.

Canada's stake in maintaining good relations with the USSR centers almost exclusively on grain exports.

The Soviet View

While the Soviets were surprised by the extent of Western trade sanctions, they undoubtedly expected them to fade after a few months as the immediate impact of the Afghanistan action wore off. Soviet officials probably also believed that Western Europe and Japan would continue business as usual with them, including picking up contracts denied American firms by US actions. The only serious concern at the outset

focused essentially on the US grain embargo and to a lesser extent on Western participation in the Moscow Olympics.

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To counteract the sanctions, Moscow turned quickly to obtain non-US Western grain supplies. Moscow also asked the East European countries for help. Most of the activity with the Bloc that we can confirm consists of requests for stepped-up deliveries from domestic grain production rather than transshipment or diversion of US grain. Hungary, for example, has agreed to an unprecedented Soviet demand to provide 800,000 tons of grain this year from its own crop, and we believe requests may have been made to other Bloc countries.

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The East Europeans fear that the present atmosphere will harm their efforts to expand ties with the West. In any case, they can do relatively little for the USSR. Because of their own economic problems, the East European countries are reluctant to divert goods from domestic use or from exports to the West. Transshipping Western commodities could invite a retaliatory cutoff of Western exports. Poland in particular would not want to risk losing US grain.

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Moscow, expressing impatience with the industrial countries that have been stalling on new credits and discouraging their businessmen from dealing with the Soviets, is now threatening to retaliate against Western denials. Soviet officials have become more and more explicit in discussing the USSR's capacity for economic reprisals, especially by manipulating energy supplies to Western Europe. Last month, for instance, a Soviet press item warned that Bonn "might have to relinquish important energy and other raw materials imports" and stated that a tough German stance on sanctions "would risk further normalization of relations with Eastern Europe as well."

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While frustrated by Western sanctions, Moscow is unlikely to abandon the tactics it has pursued since the sanctions were imposed. We doubt, for instance, that the Kremlin is ready to write the West out of the upcoming Five-Year Plan, as it may be doing to the United States. For the time being, the Soviets will continue to search for the weak link in Western solidarity, playing competitors off against each other. In all likelihood, the Kremlin still questions whether Western Europe and Japan believe Afghanistan to be an important enough issue to jeopardize long-term trade and economic cooperation with the Soviet Bloc.

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Moscow could overcome many of its grain problems with a good harvest this year. As of early June, the prospects for an above-average grain crop—about 210-220 million tons—appeared to be good. This would be a substantial recovery from last year's 179-million-ton crop but still well below the 1978 record of 237 million tons.

Although prospects for an above-average grain crop of 210-220 million tons are good, the USSR would like to import up to 35 million tons of grain during the year ending in September 1981 in order to expand the livestock sector. In part because of the grain embargo, however, effective port capacity has been reduced below the level needed to handle such imports. Port constraints have been tightened because the embargo has forced the use of smaller vessels and disrupted shipping schedules. Beginning in March, Soviet grain imports probably have been about one-half million tons less per month than would have been possible with normal shipping patterns.

Port capacity will continue to be the critical constraint on Soviet grain imports for at least several more months. Over the entire October 1980–September 1981 period, grain supplies available to the USSR will probably be at least 30 million tons if non-US suppliers do not restrict sales and US sales are limited to 8 million tons; but Moscow may be physically unable to import more than 30 million tons of grain and other feedstuffs unless problems of scheduling and poor management can be sorted out. Whether the Soviets can make the necessary adjustments remains to be seen.

Phosphate Fertilizers. The US embargo has impeded standing Soviet efforts to relieve chronic shortages of phosphate fertilizers. We estimate that the USSR could increase its grain harvest by 4-6 million tons with the fertilizer produced from the 1 million tons of US-origin superphosphoric acid originally scheduled for 1980 delivery. Soviet orders of superphosphate fertilizer and phosphoric acid from non-US suppliers apparently have already offset the loss of about one-fourth of the US material. Prospects for additional Soviet acquisitions of phosphate materials are considered good, particularly if premium prices are offered.

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Impact on the Soviet Economy

The impact of economic denial measures on the USSR has always depended critically on whether the US acts alone or is joined by other major suppliers and how long the measures remain in place.

Grain. The US embargo on shipments of grain and feedstuffs has further stretched domestic feed supplies—already short because of last year's poor harvest of grain and forage crops. Moreover, the late spring this year reduced access to spring pasture and delayed development of forage crops, increasing pressure on available feeds. As a result, the leadership's long-standing program to upgrade the diet through expanded meat production has once again been set back.

With less feed, slaughter weights as well as milk yields have been declining since the first of the year. Despite some increase in slaughtering, meat production on state and collective farms grew only slowly. More importantly, cumulative additions to cattle herds on state and collective farms during the first four months of the year were the lowest of any comparable period since 1976, and monthly changes in hog numbers indicate a small drop, unprecedented in the eight years for which we have statistics. The consequences of trying to stretch feed supplies as far as possible while maintaining herd levels are being increasingly felt by consumers. Endemic shortages of meat and butter are now becoming even more severe.

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Industry. Technology sanctions will have little short-run impact on the USSR. Even with Allied cooperation the USSR probably could recover rather quickly from embargoes on key items. Moscow, for instance, could accelerate its purchases of petroleum equipment once the embargo is lifted. The Soviets have already bought or are in final negotiations for all the steel pipe needed this year. The biggest problem is finding spare parts, particularly for computers. Although, for example, the denial of US computer parts at the KAMAZ truck plant has not yet resulted in any known shutdowns, the main IBM foundry computer probably will shut down before the end of the year and inactivation of other US computers at the complex—used for material handling tasks and engine testing—could introduce painful disruptions. [redacted]

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Implications for the Future

Assuming Western unity, a long-term embargo on technology transfer would impose increasingly severe problems for the Soviet economy. For while Moscow may have written off the US as a future source, Soviet planners are assuming continued access to technology from Western Europe and Japan. The need for Western technology and capital will grow as the USSR's economic performance slows in the 1980s. [redacted]

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For the time being, Moscow can afford to buy—even at premium prices—the goods the West is willing to sell. Thanks to the recent runup in energy and gold prices the USSR enjoys a comfortable foreign exchange position. We believe this cushion will last only a couple of years. As the oil outlook darkens and the USSR moves closer to being a net oil importer, finances will become a constraint on imports, and with it access to Western technology. In these circumstances, credit availability will become a far more crucial factor than it is today. A general tightening of credit offerings effectively lowers Soviet import capacity, reducing the pool of Western resources available to the USSR to alleviate its economic problems. [redacted]

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